

**United States Senate  
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS  
*Committee on Governmental Affairs***

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***Senator Norm Coleman, Chairman  
Senator Carl Levin, Ranking Minority Member***

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**OPENING STATEMENT OF NORM COLEMAN  
CHAIRMAN  
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**

**Hearing on  
*DOD Contractors Who Cheat on Their Taxes and What Should Be Done About It***

Good morning and welcome to today's hearing. We are holding this hearing to address a continuing and growing problem at the Internal Revenue Service pertaining to the collection of delinquent taxes. In particular, our focus today is on Department of Defense contractors who receive billions of dollars in contract payments each year and who currently owe \$3 billion in unpaid taxes.

Under the Taxpayer Relief Act of 1997, the Internal Revenue Service has authority to levy fifteen percent of these contractors' payments, if the Department of Defense refers its contract payments to the Financial Management Service and the Internal Revenue Service has made these cases available for collection. However, the Department of Defense is not referring all of its payments and the Internal Revenue Service has not made all of these cases available for collection. These failures are costing the government over a hundred million dollars in lost tax revenue each year.

No one likes to pay taxes. But taxes are a necessity because freedom is not free. Our taxes help to fulfill the American dream. They provide for the nation's defense. They promote commerce and fair trade. They protect workers, promote health, and provide for education. They preserve our natural resources, advance research and preserve our culture. They feed the hungry and house the poor. They ensure justice and provide transportation. In short, taxes are the membership dues we pay to preserve our way of life. All Americans are beneficiaries of the federal tax system.

The focus of today's hearing is DOD's contractors who have abused the federal tax system. Some of these abuses are appalling in their audacity and contemptible in their abject selfishness. They cannot and should not be tolerated. Those who are committed to the service of this nation must bear their full responsibility in that service.

I am especially concerned about DOD contractors who have withheld payroll taxes in trust for their employees and have failed to remit those taxes, cheating not only their own employees but the American people. The adverse impact on taxpayers' faith in the fairness of our tax system would be reason enough to remedy this problem; however, these employers' betrayal of their own employees demands our attention.

An investigation recently completed by the General Accounting Office found that over 27,000 federal contractors at the Department of Defense owed about \$3 billion in unpaid taxes. If properly administered, the Debt Collection Act of 1996 would have provided DOD with the opportunity in fiscal year 2002 to collect at least \$100 million from these contractors. However, because DOD has not fully implemented the provisions of the act, only \$332, 000 was collected. This problem has been further exacerbated by IRS' failure to aggressively pursue collections against these contractors. Specifically, IRS' increasing collection workload and decreasing collection resources have led IRS to freeze collection activity in one of every three collection cases. Further, IRS has allowed many collection cases to interminably languish in their antiquated collection process. In order to improve collections, DOD and the Internal Revenue Service must work with the Financial Management Service to identify delinquent contractors and levy their contract payments.

Let me outline some of the most egregious tax abuses that have occurred:

- A business that provides snow removal and landscaping services at a military base was awarded contracts worth over \$1 million and owes over \$1million in unpaid payroll and unemployment taxes. During 2002 the contractor received over \$200,000 from DOD.
- An individual business that performs repair services on military vehicles owes over \$500,000 in business and individual taxes. This contractor has contracts with DOD that are worth over \$60 million and recently received an annual payment of over \$100,000.
- IRS suspended collection activity against a contractor in 1999 because IRS believed the contractor lacked the funds to pay their tax debt. However, between 1999 and 2002, DOD paid the contractor almost \$700,000.
- IRS initiated collection against a DOD contractor who owed about \$270,000 in unpaid taxes. Because of its workload, IRS suspended collection activity against the contractor for 10 months. IRS then reinitiated collection against the contractor and placed the contractor's case in a queue of collection cases awaiting assignment. The contractor remained in the queue for 19 months. During this 29 month period, DOD paid the contractor at least \$110,000.

With the passage of the Debt Collection Improvement Act of 1996, Congress obligated DOD to levy their contractor payments to ensure that individuals and businesses who receive federal payments and have failed to pay their just tax can have a portion of their payments forwarded to the IRS to satisfy their tax debt. The Federal Payment Levy Program administered by the Financial Management Service, relies on computer matching of information provided by IRS and DOD. If the taxpayer identification information is incorrect or not provided, then the Financial Management Service cannot match the DOD and IRS information. As a result, the IRS cannot effectively identify nonfilers, determine their full tax liability and levy contractors' payments to collect the taxes that are owed and DOD will continue to fully pay tax scofflaws who are abusing the federal tax system.

Where we find fraud and abuse, we must fix it and stop it from occurring again. As we begin this hearing, I want to reiterate my commitment to finding solutions to problems in government.

This morning we will hear from representatives of the General Accounting Office on their recently completed investigation of DOD contractors who habitually abuse the federal tax system. We will also hear from DOD, IRS, and the Financial Management Service concerning the actions they have taken or plan to take to ensure that DOD contractors pay their fair share of taxes.

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